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C O N F I D E N T I A L SECTION 01 OF 02 KYIV 000089

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TAGS: [EFIN](#) [ECON](#) [ENRG](#) [EREL](#) [PGOV](#) [UP](#)
SUBJECT: UKRAINE'S ACTING FINANCE MINISTER SURVIVES 2009,
BUT 2010 WILL CONTINUE TO BE CRUEL

REF: KYIV 008

Classified By: Ambassador John F. Tefft for Reasons 1.4 (b) and (d)

11. (C) Summary. Ukraine's government still hopes for revisions to the IMF program that would allow it to access \$2 billion currently held in reserves at the National Bank of Ukraine (NBU), according to Acting Finance Minister Umanskyi. Without access to IMF money, the first quarter of 2010 would be very difficult for Ukraine, which was already running a large internal government deficit. Umanskyi said he wanted to limit domestic borrowing, due to the high interest rates creditors currently demanded, because such borrowing could drive the economy into default. Umanskyi also cautioned that Nadra Bank had lost its importance as a systemic bank, and as a result the government's incentive to recapitalize the bank was diminishing. Finally, Umanskyi, who said 2009 was the type of year for which Finance Ministers are shot, predicted continued difficulties for Ukraine in 2010 and a need for continued IMF lending. End Summary

Government of Ukraine Still Looking for IMF Revision/Money

12. (C) Ukraine's government still hoped for a revision of the IMF program that would free up \$2 billion from the National Bank of Ukraine (NBU) for government use, according to Acting Minister of Finance Ihor Umanskyi during a January 14 meeting with the Ambassador. Ukraine had sent a working level delegation to the United States for meetings with Treasury, the IMF, and others on January 14 and 15 to again discuss the possibility of reallocating funds to designate them as government (rather than NBU) liabilities. Umanskyi stated that the GOU understood a quick revision of the IMF program was not likely, but stressed that the GOU still needed the \$2 billion to cover domestic obligations in the first quarter of 2010. Nothing would change from the point of view of the IMF: Ukraine had still drawn \$10.6 billion to date as part of its stand-by arrangement. Ukrainian prohibitions on direct NBU funding of the national deficit, however, meant Ukraine needed the IMF to reallocate the \$2 billion. (For additional details of GOU's request to the IMF see reftel.)

First Quarter Deficit Larger Than Normal

13. (C) Umanskyi confirmed that the government already faced a deficit of UAH 14 billion (\$1.75 billion) in the first quarter of 2010 as a result of depleted Treasury accounts, low consumer spending in the holiday month of January, and

central government arrears to local budgets of UAH 8 billion (\$1 billion) at the end of 2009. In addition, first quarter corporate tax revenues were traditionally low.

14. (C) Adding to Ukraine's budget woes, government payments to Ukraine's pension fund were growing. Umanskyi explained that the pension fund had been underfunded starting in 2004. Now about half of the money paid out each year to pensioners came directly from the national budget. The level of contributions to the pension fund from salaries had not been revised upward in many years, according to Umanskyi. As a result, the GOU budget shortfall was reaching critical levels, Umanskyi stated.

Domestic Borrowing Costly; IMF Money Needed

15. (C) Umanskyi said that Ukraine would need the IMF to continue lending in 2010. Even at interest rates in excess of 25%, there was no appetite domestically for government debt. In Umanskyi's opinion, the interest rates required by the market were too burdensome and the IMF should not suggest that Ukraine turn to domestic debt markets. He pointed to Russia's high rates of domestic borrowing and default at the end of the 1990s, stating that although Ukraine was not borrowing domestically as much as the Russians then, Ukraine still defaulted and could not borrow domestically or internationally for the following two years. Ukraine did not want a repeat of that scenario.

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----- Banking Sector Still Under Pressure; Nadra No Longer Systemic -----

16. (C) Ukraine's banking sector continued to be weak, according to Umanskyi. The banks would need help in 2010, and Umanskyi was concerned that the poor relationship between the NBU and the government would continue to hinder banking sector reform.

17. (C) Umanskyi stated that Nadra Bank, which has been under temporary administration and basically idle for the past year, had lost its importance as a systemic bank. He hinted that since Nadra was no longer important to the overall health of the sector, the GOU felt less obliged to recapitalize it. Umanskyi said that international creditors had been unwilling to accept multiple offers, hoping that the government would infuse capital into the bank. In addition, Nadra's assets continued to deteriorate. As a result, the creditors may have "fooled themselves," Umanskyi advised. The Ambassador noted USG interests in Nadra Bank and advocated for a fair and transparent process.

----- Finance Ministers Are Shot For Years Like This -----

18. (C) In Umanskyi's opinion, 2009 had been one of the hardest years economically for Ukraine since independence; but on the bright side, he said, Ukraine had avoided default. "Finance Ministers are shot for years like this," Umanskyi stated, clearly feeling vulnerable. Umanskyi predicted that 2010 would not be any easier and that real reform was still needed, not just a return to the old ways.

Comment

19. (C) Given the dismal state of Ukraine's economy, which contracted 14% for the whole of 2009, and its large government deficit, Ukraine has little choice but to continue to seek funding from outside. Ukraine's next president will

need to start economic reform as soon as possible after taking office to restart IMF and lending from other international financial institutions. Until IFI lending restarts, Ukraine will need to rely on other sources of funding -- drawing down on reserves, domestic borrowing at high rates, and possibly loans from Russia -- but in the eyes of many, including Acting Finance Minister Umanskyi, these sources of funds are less desirable and do not lead to reform that would put Ukraine on the path to sustainable economic growth.

TEFFT